
Session 3 (Day 2 Morning)

Attracting Private Investment

Session Overview

Creating a physical and administrative environment that is attractive to business is one of the most important responsibilities of local government. Both the regulatory process and the delivery of public services contribute to this objective, and each is a cost to business. In a decentralized governing system, local governments have more rights and responsibilities in establishing limits on such concerns as protection of the environment, building codes, physical appearance, use of land, and so forth. This session looks at this concept from the perspectives of the private investor and the public sector.

Session Objectives

- < To identify the factors that affect business start-ups, expansion, and the long-term profitability of a firm.
- < To identify those factors that local governments can change, as well as those that they cannot.
- < To explain how local governments can overcome barriers to private investment, either directly or indirectly.
- < To explore the impact of local-level legislative and administrative problems on general development issues.
- < To examine the conditions in the participants' countries that affect local economic development.
- < To consider what additional resources would be needed to address obstacles to local economic development.



Trainer's Notes

1½ hours Presentation: Attracting Private Investment

This presentation is based on the talking points and overheads that follow the presentation notes. You will need to refer to these to prepare this presentation.

5 min 1. Begin by welcoming the group and reviewing what took place at yesterday's session. Ask participants if they have any questions about what they learned yesterday.

5 min 2. Explain that this session will focus on what factors affect business investment decisions and what local governments can (and cannot) do to affect these decisions. Review the objectives for this session. Briefly go over the schedule of the day's activities. Remind participants to ask questions as they arise.

10 min 3. To get participants thinking about the issue under discussion, ask them how global trends affect the local climate for economic development. Ask them what national or international trends or might have an effect on private investment. List these on the flip chart.

20 min 4. Use the responses of participants to lead into a discussion of the aspects that affect an investor's decision. As you display the overhead that introduces three questions that should be used to examine the services and investment environment, ask participants what issues might surface in their communities when addressing each of these questions. Then, lead a discussion of some of these questions, using the talking points.

20 min 5. Continue the discussion by focusing on how the local government and other key players can affect the issues and questions the group has listed. Use the talking points.

20 min 6. Ask participants to reflect on what you have discussed. Based on what they know, what characteristics should local governments have in order to stimulate investor activity? List their responses on the flip chart. When they have completed the list, add any of the following responses that have not been mentioned:

- < Vision
- < Political will to implement changes
- < Capacity to stimulate demand for the provision of quality services
- < Capacity to deliver a clear and succinct mission
- < Capacity to implement coherent citizen support and public outreach programs

- < Well-informed and well-respected decision makers
- < Capacity to develop and implement a strategic plan linked to long-term investment, planning, economic, development, and community needs.

5 min 7. As a group, review the list of characteristics you have developed and lead a discussion on which elements are most important for attracting investment.

5 min 8. Conclude with a summary of the discussion. Key points to consider are:

- < Any differences between what participants actually thought was important to business investors and what was highlighted in the presentation.
- < The types of issues that local government can address.
- < That local government and communities can make small adjustments in how they manage programs and projects that are valuable to the private investors but do not require legislative changes at the national level.

9. Explain that after the break, participants will return to engage in small-group work.

1½ hours Group Assignment: Identifying the Barriers to an Investment Environment

5 min 1. Break participants into small groups. Each group should have between three and six participants.

10 min 2. Introduce the activity by explaining that investors are confronted with many problems that reduce the ability of their firm to generate wealth. In a decentralized system, these are problems that local governments must confront. Distribute the handout, “Identifying the Barriers to Creating an Attractive Investment Environment.” Explain that each of the five barriers listed on the handout relates to a local government responsibility. Working in small groups, participants should select one barrier. Then they should answer the questions on the handout to explore how it is affecting their local investment environment and what can be done to alleviate it. Allow a few minutes for participants to read over the handout, and ask if there are any questions before beginning.

30 min 3. Allow participants 30 minutes to work in their small groups. Give a reminder when there are about 5 minutes before you will reconvene.

25 min 4. Convene the whole group and ask each small group to briefly report on its discussion, using the questions on the handout as a guide. After each small group’s report, ask for feedback from the group. In particular, look for similarities and differences among the findings of the small groups. (*Time needed will depend on the number of groups.*)

20 min

5. Conclude with a summary of the discussion. Ask, “What did you learn from this exercise?” Answers should include:

- < Local governments can reduce barriers through local action; they do not need to wait for the national government to change its laws or policies. Specific examples should illustrate how the local government might be able to get around some of the obstacles discussed.
- < Public officials play a key role in entering into sound dialogue with private business; knowledge of business’s needs is required to build partnerships, as are skills in negotiation and communication.
- < Public action can create an attractive investment environment for private enterprise; some specific techniques should be reviewed.

6. Remind participants of the time and place to reconvene after lunch.



Talking Points: Attracting Private Investment

Investment in local governments has been undergoing significant changes in the E&E region over the last decade. There is a strong trend toward decentralization and greater private-sector involvement not only in the provision of services but also in the economic development within local governments. This movement increases the responsibility of local governments to think strategically about how to deliver improved public services and improve the investment environment.

Three questions that affect private investment:

Question 1: Are the legal and regulatory environments conducive to investment?

- < What bureaucratic procedures must be followed to start a new business?
- < Are contract laws reliable?
- < How can I recover my money if a contractor fails to deliver the product?
- < How much of the local economy does the local government control? What controls are in place?

Question 2: Who provides and pays for public services?

- < How much do the services cost? Is the cost structure transparent?
- < Who provides the services?
- < Are the services reliable?
- < Can I locate my business in the location where I am able to best exploit cost advantages? Can I move my goods easily to exploit cost advantages?

Question 3: How can you utilize existing assets to enable the private sector to achieve comparative advantage in the local economy?

- < How can I buy land to build a warehouse?
- < What assets does the local government have that will provide business cost advantages?

Are the Legal and Regulatory Environments Conducive to Investment?

In the E&E region, country experts stress that the reform of the legal and regulatory environments is a prerequisite to local government's ability to attract investors, especially foreign investors. Potential investors cite as obstacles heavy tax burdens, crime and security issues, inadequate credit and financing availability, a complex and seemingly endless maze of bureaucratic regulations, and constantly changing tax laws. The national government thus plays an important role in creating an enabling environment for investors to participate in a local economy. Its responsibilities are to:

- < Ensure the stability of fiscal and regulatory policies. Volatility and instability in these policy environments inhibit investor activity. If investors are uncertain of the climate in which they are undertaking business, they will be less willing to take the inherent risk of new investment.
- < Ensure macroeconomic stability. Fiscal policies should encourage low inflation and stable exchange rates. This may require a reduction in public spending.
- < Fix the legal framework. Investors need a stable, reliable legal framework that guarantees property rights and allows for the development and enforcement of contracts.
- < Streamline processes and controls. Governments need to reduce the red tape involved in administrative and regulatory controls. All processes should be transparent and consistent.

Local governments also can play an important role in influencing the local investment environment. For example, they can provide services designed to help investors navigate both local and national tax and regulatory systems, creating a "one-stop shop" for investors that could serve as a central point of contact for businesses working with various government departments or agencies. The local government also should keep local taxes and regulations investor-friendly by considering their effect on businesses and the overall investment environment.

Local governments can play an equally important role in influencing the broader investment environment by working independently and through municipal associations to encourage appropriate national reforms.

Who Provides and Pays for Public Services?

Those consumers who directly benefit from a public service should pay an increasing share of the costs of that service through direct user fees or charges. The use of user fees is compelling because it provides increased revenue streams

not only for operation and maintenance of services, but also for investment. User fees typically improve economic efficiency and minimize waste.

Revenue requirements serve as a basis for calculating prices of services. From the perspective of the investor, the charges should cover operating and maintenance costs and allow for investment to preserve or improve service delivery and profit. From the consumers' perspective, the charges should be transparent and equitable and should enable comparative advantage.

Deciding who should provide services is the responsibility of the local elected body. In many E&E countries, local governments have experienced difficulties in financing the investments necessary for service provision. There are two main reasons this occurs: (1) low revenues and high citizen expectations hamper the public sector's ability to invest in infrastructure at a sufficient level; and (2) public-sector debt and other management difficulties interfere. As a result, many local governments have considered abdicating the responsibility for providing services to the private sector.

Private-sector involvement in the provision of services has the following advantages:

- < The private sector is free from government intervention in the day-to-day management and is protected from political pressure.
- < The private sector is released from the constraints on financing that are imposed on public ownership.
- < Access to capital markets makes it easier for the private sector to pursue effective investment strategies for cutting costs and improving standards of service.
- < A system of economic regulation ensures that the benefits of greater efficiency are passed on to customers in the form of lower prices and better service.
- < Private companies are better able to attract high-quality management from other parts of the private sector.

From the perspective of an investor in the local economy, it is crucial that quality services be provided at reasonable prices to ensure comparative advantage. Usually, the private sector is able to deliver better services than the local government. This often acts as a catalyst for investors to participate in the local economy. To encourage private-sector involvement, local governments have to establish appropriate policies, regulations, and ordinances.

How Can You Use Existing Assets To Enable the Private Sector To Achieve Comparative Advantage in the Local Economy?

Investors in a local economy often ask what assets are available that will enable comparative advantage. In particular, they are interested in what land is available for development or what developed properties are available for rehabilitation and business occupation.

Privatization of land and property is an important method of triggering private investment, particularly for small and medium-sized enterprises. Local governments privatize land and property in a number of ways. One is restitution, which is the process of restoring land and property to previous owners or their successors in title. However, in some countries there is limited ability to restore land to the previous owners because prior ownership was insufficiently documented.

Ultimately, successful private-sector participation in land and property development will take place when:

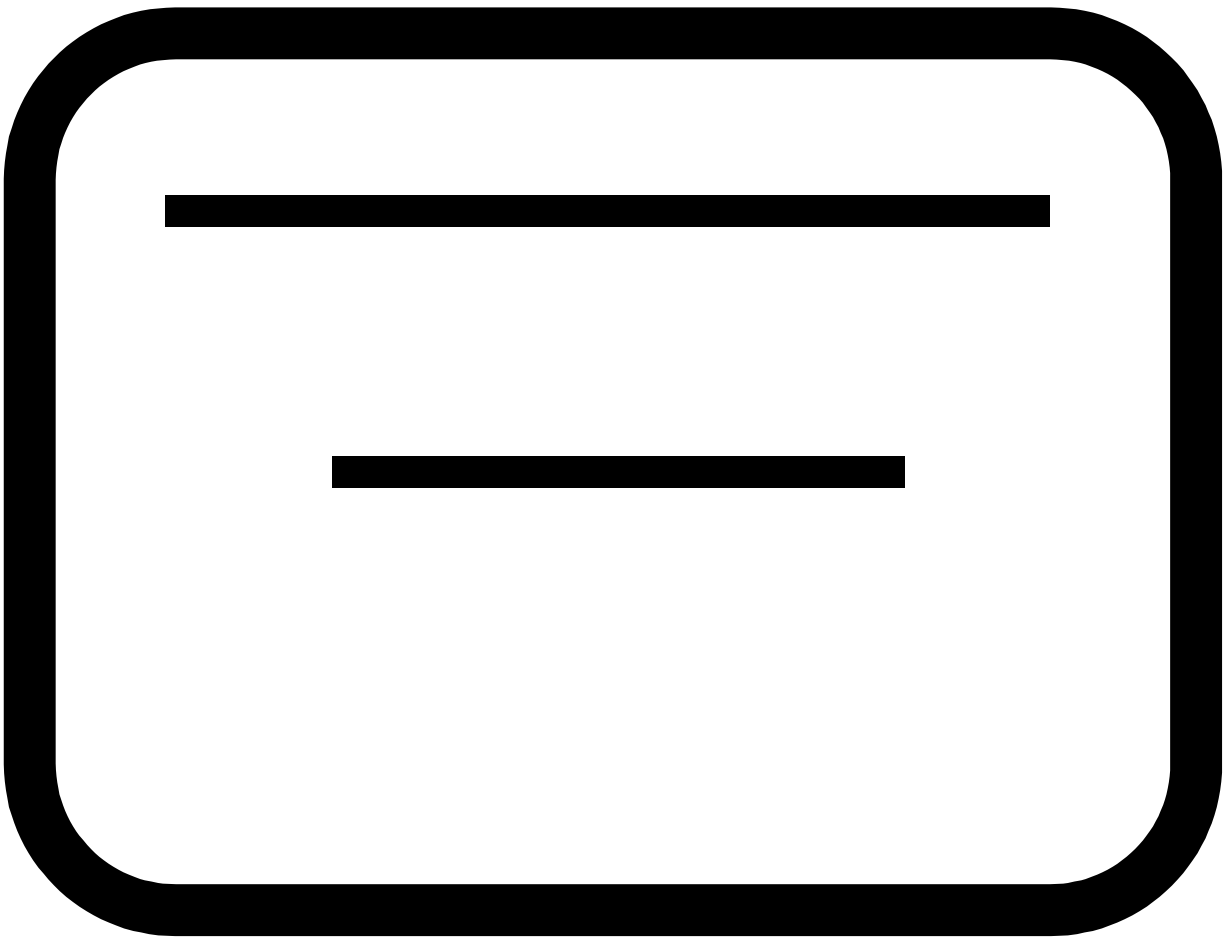
- < The title to all parcels of land is soundly based in law.
- < Transactions are recorded in a way in which the legal title and other significant legal interests can be proven with reasonable speed and cost.
- < Access to capital financing based upon an effective mortgage system is available through a commercial banking system.
- < Statutes and laws do not impose undue statutory or fiscal constraints on transactions (such as sales and leases).
- < Expertise is available to advise on legal, valuation, and other issues affecting the land.
- < The local government builds public-private partnerships for land development.
- < The local government uses its zoning powers to steer development.

Impediments to public-private partnerships and access to credit for private development are enormous in the E&E region. Without a developed banking system, a title system for private property, fiscal cadastres, and mortgage laws, local governments must find creative ways to assist investors in securing access to property and buildings. Local governments in the region have addressed these issues in a number of ways, including:

- < Constructing new commercial building space for a business (Romania).
- < Conducting an inventory of the condition of vacant or underused enterprise buildings and negotiating affordable rents for the investor (Romania).
- < Assembling land for capital projects that will increase the value of land for business development (Hungary).

Excellence in service delivery—providing the infrastructure and services needed by businesses to succeed—is also an important element in attracting new business and maintaining existing business, as well as in encouraging business growth.

Overheads



Attracting Private Investment to Local Governments

What Should Local Governments Do?

Global Trends

Investment in local governments has undergone significant changes in recent years:

- < Strong trend toward decentralization
- < Greater private-sector involvement in the provision of services
- < Greater private-sector involvement in economic development

With that comes:

- < Increased responsibility of local governments to think strategically about how to improve the investment environment and involve the private sector in delivery of services

How To Improve Investment Opportunities in the Local Economy

Examine the issue in terms of three questions:

- < Are the legal and regulatory environments conducive to investment?
- < Who provides and pays for public services?
- < How can you utilize existing assets to enable the private sector to achieve comparative advantage in the local economy?

Is the Legal Environment Conducive to Investment?

National government responsibilities:

- < *Ensure the stability of fiscal and regulatory policies.* Stable fiscal and regulatory policies encourage investment activity.
- < *Ensure macroeconomic stability.* Fiscal policies should encourage low inflation, stable exchange rates, and reduced public spending.
- < *Fix the legal framework.* Investors need a stable, reliable legal framework in order to conduct business.
- < *Streamline processes and controls.* Governments need to reduce the red tape involved in administrative and regulatory controls.

Is the Regulatory Environment Conducive to Investment?

Local government responsibilities include:

- < Providing services to help investors navigate local and national tax and regulatory systems, e.g., a “one-stop shop” that provides a central point of contact
- < Considering the effect of local taxes and regulations on businesses and the investment environment; reviewing and refining local regulations to keep businesses competitive
- < Actively participating in regional and national associations
- < Working with other entities to implement national and European Union reforms (where applicable)

Who Provides and Pays for Public Services?

Shifting to user fees:

- < Provides increased revenue streams for operation and maintenance of services and for investment
- < Improves economic efficiency and minimizes waste
- < Requires long-term investment planning and goals
- < Requires a transparent budget and pricing of services

How Can You Use Assets To Enable the Private Sector To Achieve Comparative Advantage?

The following are important to private investment:

- < Privatization of land and property
- < Access to credit
- < Public-private partnerships
- < Excellence in service delivery

Utilizing Existing Assets

Successful private-sector participation in land and property development will take place when:

- < Title to all parcels of land is soundly based in law
- < Land sales and transactions are recorded in a way in which the legal title and other significant legal interests can be proven with reasonable speed and cost
- < Access to capital financing based upon an effective mortgage system is available through a commercial banking system
- < There are no undue statutory or fiscal constraints on transactions
- < Expertise is available to advise on legal, valuation, and other issues affecting the land
- < Local government builds public-private partnerships for land development
- < Local government uses its zoning powers to steer development

Attracting Investment

- < Constantly ask yourself the question, “What must the local government do to attract investment?”
- < Develop and implement plans to ensure that the legal and regulatory environments are conducive to investment
- < Set a regulatory regime that ensures transparent prices for services
- < Ensure that quality services are provided at fair price to ensure comparative advantage for investors in the local economy
- < Utilize assets (especially land and property) to trigger investment opportunities

What Factors within Local Government Stimulate Investor Activity?

- < Willingness among decision makers to implement changes
- < Vision
- < Clear and succinct mission
- < Ability to develop and implement a strategic plan linked to long-term investment planning, economic development, and community needs
- < Ability to establish stable linkages among the government, investors, and citizens



Handout: Identifying the Barriers to Creating an Attractive Investment Environment

Investors are confronted with many barriers that inhibit the ability of their firms to generate wealth. In a decentralized system, barriers that must be addressed by the local government include:

1. **Lack of stability:** Private investors may be concerned that if a new political party assumes leadership, the commitments that the local government has made will be retracted.
2. **Cumbersome bureaucratic procedures:** Local bureaucracies may reflect processes and procedures used under social economic systems, so that investors perceive processes related to acquiring permits, inspections, and so forth to be time consuming or laborious.
3. **Corruption:** Fraud or corruption may create unstable conditions for a business and does not allow the business to accurately project operating costs.
4. **Lack of reliable infrastructure:** Problems with the infrastructure, such as power sources, could cause costly business disruptions.
5. **Local government officials' inability or lack of desire to understand economics of private firms.**

Directions for small groups:

Select one of the above constraints. Then, working in your small group, answer the following questions:

1. What is the relationship between the execution of the local government's responsibility and the impact it has on the community's ability to attract new enterprises or to strengthen existing enterprises?
2. How does the problem affect decisions made by businesses in your country?
3. What steps have already been taken to resolve the problem? Were these steps effective?
4. How would you resolve the problem in your country? What local government actions are needed to address the condition? What national government actions are needed?
5. How could a USAID project address the problem or constraint?

You will have 30 minutes to discuss these questions. Be prepared to report on your discussion.